

CRS Report for Congress

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The Budget for Fiscal Year 2004

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Summary

The Administration's fiscal year (FY) 2004 *Mid-Session Review* (MSR; July 15, 2003) estimated the FY2004 deficit at \$475 billion, up from the \$307 billion deficit in the President's original FY2004 budget proposals (February 2003). Changes in policy, a slowly recovering economy, and other estimating factors produced the growth in the estimated deficit. The Administration's July estimates "do not reflect ... expected but undetermined additional costs arising from ongoing operations in Iraq, extending beyond 2003" (the Office of Management and Budget [OMB] Mid-Session Review, July 15, 2003, p.1). Any increase in outlays or decreases in taxes (without offsets) will increase the deficit.

CBO's *Economic and Budget Outlook: An Update* (Update; August 26, 2003) projected a baseline deficit of \$480 billion in FY2004, a \$280 billion increase from its March 2003 baseline estimate and higher than the \$458 billion baseline deficit estimate in OMB's MSR. Over 80% of the increase resulted from spending bills and tax cuts adopted between March and August 2003. (Revised FY2004 budget estimates will be included in the FY2005 budget reports.)

The President's February (2003) FY2004 budget proposals included a deficit of \$307 billion, assuming the adoption of those proposals. The proposals included speeding up and making permanent many of the tax cuts enacted over the last two years, along with new tax changes for economic stimulus, tax incentives, and expiring tax provisions.

On January 31, 2003, CBO released the first of its annual budget reports. CBO's baseline had a \$145 billion deficit in FY2004. Because the CBO baseline only incorporates existing policy, it does not reflect the effects of likely policy changes.

Congress cleared the conference report (H.Rept. 108-71, H.Con.Res. 95) on the FY2004 budget resolution on April 11, containing reconciliation instructions for a tax cut. A little over a month later, on May 23, Congress adopted the conference report (H.Rept. 108-126) on H.R. 2, the bill containing an 11-year, \$350 billion tax cut that implemented (in modified form) the reconciliation instructions in the budget resolution. It became law (P.L. 108-27) on May 28.

The passage of the 13 regular appropriation bills faltered in the fall of 2003. Three of the bills had become law at the start of the new fiscal year. As Thanksgiving approached, six appropriations had become law; the remaining seven were being bundled into an omnibus measure (H.R. 2673, which the House passed on December 8). Congress passed and the President signed the fifth in a series of continuing resolutions (CRs) on appropriations (P.L. 108-185; December 16, 2003) that funds activities not otherwise funded through January 31, 2004. The Senate is expected to consider the omnibus appropriation measure in late January 2004. This report will be updated as events warrant.

Contents

Background and Analysis	1
The Current Situation	1
Budget Totals	2
Budget Proposals and Estimates	2
Uncertainty in Budget Projections	6
Budget Action	8
Outlays	10
Receipts	13
Deficits and Surpluses	16
CBO's Alternative Policies Not Included in the Baseline	18
The Longer Run	18
The Budget and the Economy	19
For Additional Reading	20
CRS Products	20

List of Tables

Table 1. Budget Estimates for FY2004	3
Table 2. CBO's Alternative Scenarios, Cumulative Surpluses/Deficits(-); FY2004-FY2008 and FY2004-FY2013	7
Table 3. Outlays for FY2003-FY2008 and FY2013	11
Table 4. Receipts for FY2002-FY2008 and FY2013	14
Table 5. Surpluses/Deficits(-) for FY2004-FY2008 and FY2013	17

The Budget for Fiscal Year 2004

Background and Analysis

Presidents generally submit their budget proposals for the upcoming fiscal year (FY) early in each calendar year. The Bush Administration released its FY2004 budget (*The Fiscal Year 2004 Budget of the U.S. Government*) on February 3, 2003. The multiple volumes contained general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2004 and for the years through FY2008, with information on the revenue changes through FY2013 and a section on long-term fiscal issues facing the nation. The full set of budget documents (*Budget, Appendix, Analytical Perspectives, Historical Tables*, among several others) contain extensive and detailed budget information, including estimates of the budget without the proposed policy changes (current service baseline estimates), historical budget data, detailed outlay and receipt data, selected analysis of specific budget related topics, and the Administration's economic forecast. In addition to its presentation of the Administration's proposals, the budget documents are an annual basic reference source for federal budget information.

The Administration's annual budget submission is followed by congressional action on the budget. This usually includes the annual budget resolution, appropriations, and, possibly, a reconciliation bill (or bills). During the months of deliberation on budget legislation, the Administration often revises its original proposals because of interactions with Congress and changing circumstances in the economy and the world.

The Current Situation

Congress recessed after Thanksgiving without completing action on the FY2004 appropriations. Six of the appropriations were adopted before the recess; the seven remaining regular appropriations were bundled into an omnibus package (H.R. 2673, the Agriculture appropriation), which the House passed on December 8. The Senate is expected to consider the bill in late January 2004.¹

Congress adopted a series of continuing resolutions (CRs) on appropriations, beginning in late September to assure funding for those federal activities not otherwise funded. The fifth CR (P.L. 108-185), running through January 31, 2004,

¹ Appropriations, which provide the budget authority for discretionary spending, make up approximately 40% of total spending authority available to the government each year. Mandatory spending, which (for the most part) does not need annual appropriations, makes up 60% of federal spending.

became law on December 16. It has the same end date as the previous CR (P.L. 108-135; November 22), but includes added provisions for two programs (within the Federal Housing Administration and the Federal Aviation Administration).

On November 3, Congress cleared the President's requested \$87.5 billion supplemental appropriation (H.R. 3289) for the ongoing military and reconstruction efforts in Afghanistan and Iraq. The bill also provided additional resources for Homeland Security. The President signed the bill into law (P.L. 108-106) on November 6. It would generate an estimated \$37 billion in outlays in FY2004.

Budget Totals

Table 1 contains budget estimates and proposals for FY2004 from the Congressional Budget Office (CBO), the Administration (the Office of Management and Budget, OMB), the revisions produced by OMB and CBO throughout the year, and, as they become available, congressional budget resolutions. Differences in totals occur because of differing underlying economic, technical, and budget-estimating assumptions and techniques as well as differences in policy assumptions. Most *policy* generated dollar differences between the Administration and congressional proposals or assumptions for an upcoming fiscal year are often relatively small compared to the budget as a whole. These small differences may grow, sometimes substantially, producing widely divergent budget paths over time. Budget estimates should be expected to differ over time from those originally proposed by the President or Congress.

The war on terrorism, the 2001 recession and the slow economic recovery (until it speeded up in the fall of 2003), changes in policies (tax cuts; spending increases), and changes in the technical assumptions of the underlying budget-economic relationships, have all contributed to the large deterioration in the budget outlook over the last two years.

Budget Proposals and Estimates

CBO's first budget report for FY2004, the *Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), contained baseline estimates and projections for FY2003 through FY2013.² CBO's report showed that, under baseline assumptions, the budget would remain in deficit through FY2006 (when it would be \$16 billion). The baseline showed small surpluses beginning in FY2007 and growing rapidly in FY2011 through FY2013 as revenues grow rapidly with the scheduled expiration (at the end of calendar year 2010) of the tax reductions from the Economic

² Baseline estimates provide a foundation from which to measure proposed policy changes. They extrapolate current policies and other specified conditions into the future based on expectations of future economic conditions, other factors that affect the budget, and rules set by Congress that CBO must follow in creating baseline estimates. They are not meant to predict future budget outcomes. Because they continue existing policy, the baseline estimates repeat spending that was intended for only one year only and exclude generally expected but not-yet-enacted policy changes.

Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16, June 2001).

Table 1. Budget Estimates for FY2004
(in billions of dollars)

	Receipts	Outlays	Deficit(-)/ Surplus
<i>Actual for FY2000</i>	\$2,025	\$1,789	\$236
<i>Actual for FY2001</i>	1,991	1,864	127
<i>Actual for FY2002</i>	1,853	2,011	-158
<i>Actual for FY2003</i>	1,782	2,157	-374
CBO B&E Outlook, Baseline, 1/31/03	2,054	2,199	-145
OMB, Budget, 2/3/03	1,922	2,229	-307
OMB, Budget, Current Services, 2/3/03	2,031	2,189	-158
CBO Revised Baseline, 3/7/03	2,024	2,224	-200
CBO Estimates of the President's Policies, 3/7/03	1,907	2,245	-338
House FY2004 Budget Resolution, 3/21/03	1,908	2,232	-324
Senate FY2004 Budget Resolution, 3/26/03	1,958	2,246	-287
Conference FY2004 Budget Resolution, 4/11/03	1,883	2,268	-385
OMB Mid-Session Review, 7/15/03	1,797	2,272	-475
OMB Mid-Session Review, Baseline, 7/15/03	1,794	2,252	-458
CBO Update, Baseline, 8/26/03	1,825	2,305	-480

B&E Outlook = The *Budget and Economic Outlook*, CBO.

President Bush's FY2004 budget called for additional tax cuts and both increased and decreased spending (as measured against OMB's baseline estimates) depending on the activity. The proposed policy changes increased the FY2004 deficit to \$307 billion from OMB's baseline deficit estimate of \$158 billion. OMB's current service baseline estimate moved into a small (\$5 billion) surplus in FY2006 while the President's proposals would produce a projected deficit of \$201 billion in that year. The proposals would keep the budget in deficit through (at least) FY2008, the last year of the Administration's estimates.³

The Administration's budget did not include any cost estimates for the (then future) war in Iraq, expected but unspecified additions to homeland security funding, or for non-war defense related spending. On March 24, 2003, the President asked Congress for a \$75 billion supplemental appropriation for FY2003, some of which would produce outlays in FY2004.

The Administration argued that its proposed tax cuts were needed to boost the lagging economy and that the acceleration of economic growth resulting from the tax cuts would lead to the recovery of much of the lost revenue over future years. In contrast, the President's Council of Economic Advisors, in its annual report stated,

³ The long-run outlook for government policies existing at the time of the budget submission (that are found in the budget, p. 41) indicate that, without substantial changes from existing policies, the budget is likely to remain in deficit through much of this century.

Although the economy grows in response to tax reductions (because of higher consumption in the short run and improved incentives in the long run), it is unlikely to grow so much that lost tax revenue is completely recovered by the higher level of economic activity.⁴

Both OMB's and CBO's original FY2004 budget documents were produced prior to the completion of final work on the FY2003 appropriations. This forced both agencies to estimate the (discretionary) spending levels Congress would approve and that the President would agree to for FY2003. The year-to-year budget comparisons suffered from this uncertainty.

CBO's March report, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2004* (APBP) recalculated the Administration's FY2004 budget proposal using CBO's assumptions and budget estimating methods.⁵ These recalculations produced results similar to those in the President's budget, with little cumulative difference in the projections. CBO estimated a cumulative deficit of \$1.2 trillion under the President's policies over the five years (FY2004-FY2008) compared to the Administration's estimate of \$1.1 trillion.⁶ CBO's 10-year projections of the Administration's proposals (CBO extrapolated the President's policies over the second five years) showed larger deficits (or smaller surpluses) compared to the CBO's own revised (March) baseline in each of the years covered. CBO estimated that about two-thirds of the increases in the deficits in its reestimates of the President's proposals (excluding higher net interest costs) resulted from the lower revenues that would occur from the adoption of the President's tax cut proposals.

The March 2003 revised CBO baseline (incorporating the effects of the Consolidated Appropriations Resolution FY2003 (CAR 2003, P.L. 108-7, February 20) increased the projected baseline deficit by \$47 billion in FY2003 and by \$55 billion in FY2004 over the January estimates. CBO attributed \$22 billion of the \$55 billion increase in the deficit in FY2004 to legislative changes since January (almost all from CAR 2003). The remainder of the increase was attributed to technical changes.

Over the 10-year period covered in the March CBO report, CBO wrote,

For the 2004-2013 period, CBO has reduced its projection of the cumulative surplus by \$446 billion [dropping it from \$1,336 billion to \$891 billion], nearly three-quarters of which derives from enactment of the omnibus appropriation act in February.⁷

⁴ Council of Economic Advisers, *Economic Report of the President*. Feb. 2003. pp. 57-58

⁵ The CBO report came out before the adoption of the FY2003 supplemental appropriations (P.L. 108-11, April 6) and therefore did not include any effect that legislation would have on FY2004's outlays and deficit.

⁶ *Ibid.*, p. 1.

⁷ Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for FY2004*, March 2003, p. 3.

The deterioration in the budget outlook between January and March resulted in CBO's revised baseline estimate pushing back the budget's return to surplus by one year, from FY2007 to FY2008.

The FY2004 House budget resolution (H.Con.Res. 95; March 21) included the President's request for a \$726 billion economic stimulus tax cut (only a portion of the total tax cut outlined in the resolution was included in reconciliation instructions). The Senate-passed resolution (S.Con.Res. 23; March 26) contained reconciliation instructions for a \$350 billion tax cut. The conference agreement on the resolution (H.Con.Res. 95; H.Rept. 108-71; April 11) included different reconciliation instructions for the relevant House and Senate committees. The House instructions included tax cuts of \$550 billion; the Senate instructions included tax cuts of \$350 billion. The resolution's deficit was \$385 billion in FY2004, becoming a small, \$10 billion surplus in FY2012 and rising to a surplus of \$37 billion in FY2013 (assuming the expiration of the tax cuts by 2010). The reconciliation legislation that Congress passed (the Jobs and Growth Tax Relief Reconciliation; P.L. 108-27; May 23, 2003) contained \$350 billion in tax cuts (and a small amount of spending increases) over the period FY2003 through FY2013.

The summer budget reports from OMB (July 2003, *Mid-Session Review*) and CBO (August 2003, *The Budget and Economic Outlook: An Update*) projected larger deficits for FY2004 and subsequent years than they had in their earlier budget reports. OMB estimated that the FY2004 deficit would rise to \$475 billion, \$168 billion above its January 2003 estimate.⁸ Policy changes that differed from those originally proposed by the President produced \$73 billion of the change. The largest share, \$95 billion, resulted from differences in the economic and technical assumptions underlying the two projections. These changes raised the estimated cumulative deficit for FY2004 through FY2008 by \$372 billion.

CBO's summer report pushed the FY2004 baseline deficit to \$480 billion, \$280 billion larger than its March estimate. Legislative changes (tax cuts and spending increases) raised the deficit by \$227 billion, while economic and technical revisions raised it by \$52 billion. The five-year (FY2004-FY2008) projected cumulative deficit increased by \$1,083 billion between CBO's March and August estimates, from \$362 billion to \$1,445 billion. CBO's ten-year projection for FY2004 through FY2013, showed the estimated cumulative increase in its deficit projections, between March and August, was \$2,287, from of a surplus of \$891 billion to a deficit of \$1,397 billion. The August estimate incorporated (as did the March estimate) the assumed expiration of most of the tax cuts adopted over the last several years. It also included the assumed continuation of all the spending increases adopted since March, including the FY2003 supplementals (P.L. 108-11 and P.L. 108-69), that are unlikely to be repeated annually throughout the forecast period.

Neither OMB's nor CBO's projections reflected, particularly in the years after FY2004, the effect of likely policy changes, such as modifications to the Alternative

⁸ OMB's current services baseline deficit rose from \$158 billion in January to \$458 billion in July. The report shows the cumulative deficit for the four years (FY2004-FY2008) rising to \$949 billion from the cumulative deficit in January of \$113 billion.

Minimum Tax (AMT), the costs of the ongoing efforts in Iraq and Afghanistan, the possible repeal of the scheduled expirations of the tax cuts, and the possible adoption of a Medicare drug benefit. The budgetary cost of these policy changes is very large over time and could, according to CBO estimates, add another \$1 trillion to \$3 trillion to the cumulative deficit over the FY2004 through FY2013 period. (See pages 11-14 in the *Update* for CBO's discussion of budget projections under alternative scenarios.) CBO's baseline projections indicated that the budget was (and remains) in a fundamental imbalance that will not be remedied by a return to normal economic growth. The projections imply that the only way to reduce the deficit and restore surpluses is through policy changes that cut spending and/or increase revenues.

The appropriation process bogged down in the fall of 2003. Three of the 13 regular appropriations were enacted by the start of the fiscal year. Another 3 were enacted before Congress recessed. A series of continuing resolutions (CRs) on appropriations were adopted through Thanksgiving to fund those activities not covered by other funding. An omnibus appropriation bill was constructed of the 7 remaining appropriation bills (they were combined in the Agriculture appropriation, H.R. 2673). The House passed the bill on December 8; the Senate deferred its consideration until January 2004.

Uncertainty in Budget Projections

All budget estimates and projections are inherently uncertain. Their dependence on assumptions that are themselves subject to substantial variation over short time periods makes budget estimates and projections susceptible to fairly rapid and dramatic changes. The last couple of years have demonstrated this volatility. The original proposals and estimates for FY2002, made in early 2001, dramatically changed over the 20 to 21 months of congressional and presidential action on the budget. (The budget estimates in the OMB and CBO budget documents for five to 10 years in the future are subject to even greater variability.) The early 2001 estimates for FY2002 estimated a *surplus* of \$231 billion to \$313 billion. The year ended on September 30, 2002 with a *deficit* of \$158 billion. The September 2001 terrorist attacks on the United States, the legislation adopted in response, the bursting of the stock market bubble, the weak economy, and a shift in critical underlying budget relationships, all contributed to a large change in the year's budget outcome from the originally proposed or estimated amounts. There is little reason to expect this volatility to be greatly diminished in the current or future budget projections.⁹

Information in chapter 5 (The Uncertainties of Budget Projections) of CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), indicates how significantly the budget outcome can be altered by changes in

⁹ Some things are known with certainty about the direction of future budgets. Demographics can partly determine the shape of future budgets. The upcoming retirement of the baby boom generation will rapidly drive higher the spending for Social Security and Medicare as well as other federal spending or tax breaks for the elderly in the next decade. Because all those that will become eligible for these benefits are alive today, estimating the growth in these programs is relatively straightforward.

economic and related technical factors that underpin the budget estimates. The chapter contains optimistic and pessimistic alternative scenarios for its baseline projection. The optimistic scenario assumes that the favorable economic and budget conditions of the late 1990s and 2000 recur. The pessimistic scenario assumes that the economy and the budget revert to the unfavorable conditions that prevailed in the 1970s and most of the 1980s.

The numbers in Table 2 are calculated from data in the January 2003 CBO budget report. The results reflect the wide range of possible budget outcomes under the same policies but with different and reasonable underlying assumptions about the economy and the relationship of the budget to the economy.

**Table 2. CBO's Alternative Scenarios,
Cumulative Surpluses/Deficits(-);
FY2004-FY2008 and FY2004-FY2013**
(in billions of dollars; January 31, 2003)

	FY2004-FY2008	FY2004-FY2013
CBO Optimistic Scenario Cumulative Surplus	\$566	\$4,490
CBO Baseline 1/31/03	-143	1,336
CBO Pessimistic Scenario Cumulative Deficit	-855	-1,856

Source: CBO, *The Budget and Economic Outlook: Fiscal Years 2004-2013*, Jan. 2003, p.106; CRS calculations.

The President's budget includes, in the section, "Charting a Course for the Federal Budget," the statement that "... five-year projections are fraught with uncertainty. The ... error in projecting the surplus or deficit since 1982 ... has been a \$90 billion average absolute forecasting error for the first year alone. A 90-percent confidence range for 2008 would stretch all the way from a \$281 billion surplus to a \$661 billion deficit, a range of nearly \$1 trillion."¹⁰

Budget projections are very dependent on the underlying assumptions about the direction of the economy and expected future government policy and how these interact along with other factors (such as changing demographics) that affect the budget. Any deviation from the underlying assumptions used in the budget estimates, such as faster or slower economic growth, higher or lower inflation, differences from the existing or proposed spending and tax policies, or changes in the technical components of the budget models can, and usually do, have substantial effects on moving the budget outcomes away from the earlier budget estimates and projections.

¹⁰ Office of Management and Budget. *Budget of the U.S. Government for FY2004*, Feb. 3, 2003, p. 28.

Budget Action

CBO and the Administration released their first budget reports for FY2004, in late January and early February 2003. CBO's report provided baseline estimates for fiscal years 2003 through 2013. OMB's documents provided estimates for FY2004 through FY2008 with a few instances of cumulative estimates for fiscal years 2004 through FY2013 (these were limited to revenues and provided almost no data for the individual fiscal years after FY2008). The President's budget also provided current services baseline estimates for the same years.

The Joint Committee on Taxation released its estimates of the revenue effects in the President's proposals on March 4, 2003. They showed 10-year (FY2004-FY2013) revenue reductions of \$1,535 billion. (The President's budget estimated its revenue proposals would reduce receipts by \$1,307 billion over the 10 years.) In mid-March, CBO made available its report, *An Analysis of the President's Budgetary Proposals for FY2004*, which used the Joint Committee on Taxation's tax estimates (modified) as the basis for its analysis of the revenue effects of the President's proposals. CBO's estimate showed the proposals reducing receipts by \$1,455 billion over the same 10 years.

The House and Senate Budget Committees adopted their own, differing, versions of the FY2004 budget resolution (H.Con.Res. 95; S.Con.Res. 23) in mid-March. The House, after the Republican leadership had to modify the committee-passed resolution to assure enough support for passage, passed (215-212) its version on March 21. It contained reconciliation instructions for a \$550 billion, multi-year tax cut.

The Senate spent more than a week considering its resolution. After adopting and rejecting numerous amendments, the Senate adopted the resolution on March 26.¹¹ One of the amendments adopted limited the size of the reconciliation tax-cut to \$350 billion over 11 years (from the committee-adopted level of \$698 billion). The resolution moved to a conference committee April 1, 2003. The conference reported its agreement on April 10 (H.Rept. 108-71). The agreement included different tax cut reconciliation instructions for the House and Senate. The House reconciliation instructions included tax cuts (over 11 years) of up to \$550 billion. The Senate reconciliation instructions limited it to tax cuts of \$350 billion. Without other constraints, this would have allowed a \$550 billion tax cut to emerge from a conference on the tax cut legislation. The \$550 billion would have been protected from a Senate filibuster by the reconciliation rules. To make sure the budget resolution conference report could clear the Senate, the Senate leadership agreed that any eventual tax cut legislation would not exceed \$350 billion.

The House Ways and Means Committee reported the reconciliation tax cut legislation (H.R. 2; H.Rept. 108-94) on May 8. The legislation provided for the \$550 billion tax cut included in the House version of the conference agreement on the budget resolution. The House passed the bill on May 9.

¹¹ The Senate substituted the text of its resolution, S.Con.Res. 23, for the text of the House-passed resolution, H.Con.Res. 95.

The Senate Finance Committee reported its *initial* version of the \$350 billion reconciliation tax cut (S. 2; no report) on May 9. Rules on reconciliation legislation sent the bill back to the Finance Committee. The Committee re-reported the legislation, now S. 1054 (again, no report) on May 13. The Senate adopted the legislation (with the \$350 billion tax cut limit) on May 15, after substituting the text of S. 1054 for that of H.R. 2.

On May 23, after extensive leadership negotiations between the House and Senate, an agreement was reached resolving the differences between the two versions of the tax-cut legislation (the Jobs and Growth Tax Relief Act of 2003). It provided \$350 billion in tax cuts and small spending increases through FY2013. The agreement was formalized by the conference committee's report (H.Rept. 108-126) on May 22. The House adopted the agreement in the early morning hours of May 23. The Senate adopted it before noon on May 23. The legislation included the automatic expiration of most of the new tax cuts within 1 or 2 years. The President signed the legislation into law (P.L. 108-27) on May 28.

On July 7, the President requested a second supplemental of \$1.9 billion for FY2003. A portion of the request, \$984 million, cleared Congress (H.R. 2859) in late July and became law (P.L. 108-69) on August 8. Most of the spending (outlays) from this legislation will occur in FY2004 and subsequent years.

Work on the appropriations for FY2004 began in the spring of 2003 and continued through the summer. When Congress returned after its summer recess in September 2003, the House had passed 11 of the 13 regular appropriations and the Senate had passed 4. None of the appropriations had become law. By September 9, the House had passed its versions of all the appropriations. The Senate had passed seven of the appropriations by the end of September. Three of the appropriations cleared Congress and were signed into law by the President as the new fiscal year began on October 1, 2003. Congress adopted (on September 25) and the President signed (on September 30) the first in a series of continuing resolutions (CRs) on appropriations (P.L. 108-84; H.J.Res. 69) for FY2004. The CR was necessary to avoid a lapse in funding for the activities in the still-to-be-enacted 10 appropriations. The CR ran through October 31, 2003.

As October progressed, Congress continued its efforts to complete action on the 13 regular appropriations for FY2004. By the end of the month, the Senate had adopted nine appropriations (two more than at the beginning of the month). One more had gone through conference (Interior), but no more had become law.

A second CR, running through November 7 (P.L. 108-104; October 31, 2003), became necessary as Congress' ongoing attempt to finish its work on the FY2004 appropriations. As with the second CR, the appropriations work was unfinished as the November 7 deadline approached. A third CR (P.L. 108-107; November 7, 2003), provided funding through November 21.

Again, as time ran out on the third CR, Congress remained mired in conflict over the remaining appropriations. By November 21, the Senate had passed its versions of 12 of the 13 appropriations (Commerce, Justice, State remained

unfinished).¹² A total of four appropriations had become law and two more had been sent to the President. In an effort to assure passage of the remaining appropriations, Congress began working on an omnibus appropriation for the year that was initially expected to contain the 5 regular appropriations. Four that were not expected to pass individually — Commerce, Justice, State; the District; Labor, HHS, Ed; and VA, HUD — were added to Agriculture (H.R. 2673). The omnibus expanded to include the remaining two, Foreign Operations and Transportation-Treasury, after their enactment as separate bills became less certain. In a post-Thanksgiving session, the House passed the legislation on December 8. The Senate, meeting the next day, deferred its consideration of the omnibus until January 2004. Some members of Congress have suggested that if the omnibus fails to pass the Senate, Congress may adopt a CR for the rest of the fiscal year, providing FY2003 spending levels for these activities in FY2004.

The ongoing delays in completing the work on appropriations resulted in the need for a fourth CR. On November 21, 2003, Congress passed the fourth CR (H.J.Res. 79), which provided funding through January 31, 2004,. The President signed it into law (P.L. 108-135) on November 22. A fifth CR (P.L. 108-185), containing special provisions for two programs (under the Federal Housing Administration and the Federal Aviation Administration), but otherwise unchanged from the fourth CR and included the same January 31, 2004 end date, became law on December 16.

Congress also considered, during the second half of October, the President's requested \$87 billion supplemental appropriations, mostly for Iraq and Afghanistan. The House and Senate cleared the supplemental (H.R. 3289; S. 1689) on October 17, and sent it to conference. Various contentious provisions in the legislation lengthened the negotiations and prompted a veto threat from the Administration. The differences were resolved, resulting in the \$87.5 billion supplemental appropriation clearing Congress on November 9. The President signed the legislation into law on November 6 (P.L. 108-106).

Just before Congress broke for Thanksgiving, it passed, and the President signed on December 8, a Medicare reform proposal (P.L. 108-173; the Medicare Prescription Drug, Improvement, and Modernization Act of 2003) that would add an estimated \$400 billion to the program's cost over the next ten years.

Outlays

The Administration's FY2004 budget proposed \$2,229 billion in outlays for FY2004, rising to \$2,711 billion in FY2008, the last year forecast in the President's budget. The current services baseline in the President's budget (estimates of what future outlays would be if policies remained unchanged over the forecast period) showed outlays of \$2,189 billion in FY2004 growing to \$2,541 billion in FY2008.

¹² The House had passed its versions of all the appropriations before mid-September; the Senate had cleared 7 by the end of September and an eighth by the end of October.

The Administration's proposals, if adopted as proposed, would have raised outlays \$89 billion above the Administration's proposed FY2003 level and \$40 billion above its FY2004 current services baseline outlay estimate. The difference between the current services baseline outlay estimate and the proposed outlay amount for FY2004 measures the "cost" of the Administration's proposed policies. The year-to-year change (the \$89 billion increase) combines the effects of policy changes from year to year with the relatively automatic growth in large parts of the budget. These increases include cost-of-living adjustments, growth in populations eligible for program benefits, and inflation driven increases. The President's budget did not include estimated costs of any (at that time, possible future) conflict with Iraq for either FY2003 or FY2004.

Table 3. Outlays for FY2003-FY2008 and FY2013
(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	\$2,011 ^a	\$2,121	\$2,199	\$2,298	\$2,3878	\$2,4795	\$2,583	\$3,167
President's F04 Budget, 2/3/03		2,140	2,229	2,343	2,464	2,576	2,711	—
President's FY04 Current Services, 2/3/03		2,131	2,189	2,276	2,348	2,440	2,541	—
CBO Revised Baseline, 3/03		2,137	2,224	2,328	2,417	2,513	2,621	3,215
CBO Est. of the President's Policies, 3/03		2,143	2,245	2,370	2,491	2,606	2,739	3,452
House FY2004 Budget Resolution, 3/21/03		2,143	2,232	2,337	2,450	2,556	2,675	3,335
Senate FY2004 Budget Resolution, 3/26/03		2,148	2,246	2,372	2,491	2,607	2,734	3,338
Conference FY2004 Budg. Res. 4/11/03		2,182	2,268	2,375	2,494	2,607	2,737	3,387
OMB MSR 7/15/03		2,212	2,272	2,338	2,452	2,573	2,706	—
OMB MSR, Baseline, 7/15/03		2,210	2,252	2,304	2,377	2,481	2,587	—
CBO Update, Baseline, 8/26/03		2,157 ^a	2,305	2,404	2,501	2,624	2,761	3,422

a. Actual outlays for FY2002 and FY2003.

Total outlays, in the President's budget, were projected to grow at an average annual rate of 5.0% between FY2004 and FY2008. Broad categories of spending (budget functions) showed varying rates of growth. The health budget function would increase at an annual average rate of 7.9%, the Medicare function would increase at an annual average rate of 7.8%, and net interest would increase at an annual average rate of 9.6% over these years.^{13, 14} These three functions account for over 53% of the total outlay increase during this period. All of the other fifteen budget functions have a lower annual growth rate than that of total outlays.¹⁵ The relatively low growth in some budget functions (agriculture 0.8%, education,

¹³ Budget functions combine, "budget data according to the major purpose served" rather than by agency or program. OMB, *Budget of the U.S. Government for FY2004, Analytical Perspectives*, p. 463.

¹⁴ The Energy budget function has an even higher rate of increase, growing by an annual average rate of 18.3%, but since it only makes up 0.04% of total outlays in FY2004 and 0.07% of outlays in 2008, it has little effect on the overall change in outlays.

¹⁵ The two budget functions, "allowances," and "undistributed offsetting receipts," were excluded from the total number of functions.

training, employment, and social services 1.2%, general government 1.2%, and natural resources and environment 1.5%), growth that is lower than the expected rate of inflation, will reduce these functions' spending, both in real terms and as shares of total spending.

The January 2003 CBO baseline, which, like the Administration's current services baseline estimates, assumed no changes from existing government policy, forecast FY2004 outlays of \$2,199 billion, FY2008 outlays of \$2,583 billion, and, because CBO's estimates extended through FY2013, FY2013 outlays of \$3,167 billion.¹⁶ As should be expected, the CBO baseline estimates are similar to the Administration's current services baseline estimates for the same years FY2004-FY2008).

The estimate's revisions in CBO's March 2003 report raised estimated FY2004 baseline outlays by \$25 billion, to \$2,224 billion (mostly because of the inclusion of the effects of adopting the Consolidated Appropriations Resolution, 2003 (P.L. 108-7)) in February. Each of the succeeding year's outlays in the CBO revisions were larger than they were in the January baseline. CBO's March 2003 baseline outlays would grow by an annual average rate of 4.2% between FY2004 and FY2008 (and by the same rate for the FY2004-FY2013 period). Total discretionary spending, including defense and homeland security, would grow by approximately 2.5% a year over both the 5- and 10-year periods.¹⁷ Mandatory spending, including Social Security and Medicare, would grow at average annual rates of 4.7% (FY2004-FY2008) and 5.4% (FY2004-FY2013). Because CBO's baseline shows the budget with a surplus starting in FY2008, net interest declines in the second five years after growing quickly in the first five years. Over the 10 years, net interest grows at an annual average of 1.5% (it grows at an average annual rate of 7.8% over the five years, FY2004-FY2008). If the deficits do not disappear, as they would not under the Administration's proposals, the cost of net interest would continue increasing.

CBO's March estimates of the President's policy proposals raised outlays \$16 billion higher in FY2004 than the Administration's proposed amount. For FY2008, CBO's reestimates pushed total outlays to \$2,739 billion, \$28 billion higher than in the Administration's budget. For the years covered by the President's budget, FY2004-FY2008, CBO's reestimates raised outlays close to \$30 billion a year above the Administration's estimates, except in FY2004 when the difference was estimated at \$16 billion. By FY2013, the Administration's outlay proposals, under the CBO reestimates, reached \$3,279 billion. With spending exceeding \$2 trillion a year over the first five years, a \$30 billion difference between the two estimates is relatively insignificant.

¹⁶ These projections followed very similar rules as those used by the Administration to produce its current services baseline estimates. CBO and OMB used different budget models and a number of different underlying assumptions, which generated much of the difference in the two estimates.

¹⁷ Under the rules that CBO must use in producing the baseline estimates, one requires that discretionary spending growth matches the expected rate of inflation over the time period of the projection.

The House- and Senate-passed budget resolutions contained different levels of spending for FY2004 and subsequent years and differences in the components of that spending. The House resolution included \$2,232 billion in outlays for FY2004, while the Senate amount was \$2,246 billion, less than a 1% difference. By FY2013, the House resolution had outlays of \$3,289 billion and the Senate resolution had outlays of \$3,338 billion, a 1.5% difference. The House included instructions to cut spending in a wide selection of many mandatory programs, stating that there should be enough “waste, fraud, and abuse” in the programs affected to avoid diminishing their effectiveness. The Senate resolution strongly constrained growth in non-defense, non-homeland security discretionary spending in the second five years of the period. Whether either of the strategies to constrain spending is politically realistic is uncertain.

The conference report on the budget resolution (H.Rept. 108-71) included outlays of \$2,268 billion in FY2004 and \$3,387 billion in FY2013. In addition, the conference agreement required most of the authorizing committees in the House and Senate to report the amount of “waste, fraud, and abuse” within the programs under their jurisdiction to their respective Budget Committees by September 2003 (very few did).

The July 2003 *Mid Session Review* (MSR), reflecting the legislation adopted since the February budget release, raised FY2004 baseline outlays to \$2,252 billion from the original baseline outlays of \$2,189 billion, 3% increase. Outlays under the Administration’s policy proposals, some of which had been modified, grew to \$2,272 billion from the originally proposed \$2,229 billion, a 2% increase. Some of the change resulted from the differences between the legislation adopted by Congress and what the President originally proposed. Outlays under the proposals in the MSR reach \$2,706 billion in FY2008, slightly below the amount originally projected (\$2,711 billion).

CBO’s August 2003 baseline estimates raised outlays by \$81 billion from its March baseline estimates of \$2,224 billion to \$2,305 billion for FY2004, almost a 4% increase. By FY2008, baseline outlays would rise to \$2,761 billion, \$140 billion above the March estimates. The effects of legislation adopted since March 2003 accounted for \$92 billion of the increases in FY2004 estimated outlay totals; \$54 billion of the \$92 billion change came from legislated increases in expected defense spending.

Receipts

The Administration’s FY2004 budget included proposals for tax cuts to boost the economic recovery and to speed up and make permanent many of the tax changes enacted over the last two years. The Administration divided its revenue proposals over FY2004-FY2008 period into an economic growth package (\$390 billion over FY2004-FY2008); tax incentives (\$72 billion); tax simplification (which would increase receipts by \$13 billion); extending expiring tax provisions (\$40 billion); and miscellaneous changes (which would increase receipts by \$2 billion). The total proposal would reduce revenues from current services baseline levels by \$493 billion

between FY2004 and FY2008 and by \$1,461 billion between FY2004 and FY2013.¹⁸ The changes would slow the overall growth in receipts but would not stop them. They would grow from \$1,922 billion in FY2004 to \$2,521 billion in FY2008.

The Administration claimed that the tax-cut proposals for economic growth would speed growth by enough to recover some or all of the forgone revenue (a claim countered by CBO's March budget report that included dynamic macro-economic estimates, estimates that included the effects of the tax cuts on the economy and the effects of these estimated economic changes on budget estimates in future years). None of the three budget models CBO used to calculate the tax-cut's effect on future revenues (or outlays) showed more than a minimal feed-back effect, boosting revenues slightly above the estimates derived from the traditional (static) models.

Table 4. Receipts for FY2002-FY2008 and FY2013
(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	\$1,853 ^a	\$1,922	\$2,054	\$2,225	\$2,370	\$2,505	\$2,648	\$3,674
President's F04 Budget, 2/3/03		1,836	1,922	2,135	2,263	2,398	2,521	—
President's FY04 Current Services 2/3/03		1,867	2,031	2,235	2,352	2,469	2,593	—
CBO Revised Baseline, 3/7/03		1,891	2,024	2,205	2,360	2,504	2,647	3,674
CBO Est. of the President's Policies, 3/7/03		1,856	1,907	2,100	2,273	2,433	2,573	3,350
House FY2004 Budget Resolution, 3/21/03		1,855	1,908	2,107	2,282	2,444	2,587	3,372
Senate FY2004 Budget Resolution, 3/26/03		1,865	1,959	2,154	2,321	2,479	2,620	3,497
Conference FY2004 Budg. Res. 4/11/03		1,835	1,883	2,082	2,277	2,441	2,586	3,424
OMB MSR 7/15/03		1,756	1,797	2,033	2,215	2,360	2,480	—
OMB MSR, Baseline, 7/15/03		1,756	1,794	2,063	2,267	2,403	2,525	—
CBO Update, Baseline, 8/26/03		1,782 ^a	1,825	2,064	2,276	2,421	2,564	3,634

a. Actual receipts for FY2002 and FY2003.

CBO's January 2003 baseline estimates had FY2004 revenues of \$2,054 billion, using a somewhat different set of underlying assumptions than what the Administration used for its current service baseline estimates. The CBO estimates also assumed that the automatic expiration of the tax cuts of EGTRRA would occur at the end of 2010. The reversion to previous tax law at that time produces a large jump in projected revenues in the fiscal years after FY2010. CBO estimated that extending all the EGTRRA tax provisions that are set to expire before FY2013 would reduce cumulative revenues over the FY2004-FY2013 period by \$785 billion (from

¹⁸ These estimates are from the Treasury's *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals*. The President's budget showed a \$441 billion revenue reduction (from baseline estimates) for the FY2004-FY2008 period and a \$1,307 billion reduction for the FY2004-FY2013 period. The Treasury's estimates were produced after the release of the President's budget reflecting modifications to the proposals and adjustments to the estimates. See also the CRS Report RS21420, *President Bush's 2003 Tax Cut Proposal: A Brief Overview*, and the CRS Issue Brief IB10110, *Major Tax Issues in the 108th Congress* for more information on the proposals.

cumulative baseline revenues of \$27,923 billion).¹⁹ The estimated effect of eliminating the expiring provisions of EGTRRA would be most dramatic after FY2010. In FY2010, allowing the tax cuts to remain in effect produces total receipt estimates that are \$32 billion below the baseline estimates; in FY2011, the level of receipts would be \$156 billion below the baseline estimates; and in FY2013, they would be \$260 billion below the baseline estimates.

CBO's March 2003 revised estimated baseline revenues were smaller, by \$20 billion to \$30 billion, than the January baseline for the years FY2004 through FY2006, after which the January and March baseline estimates were very similar. CBO attributed the change to technical factors. The CBO revenue estimates of the President's proposals were smaller than those proposed by relatively small amounts (\$15 billion to \$30 billion) for fiscal years 2004 through 2006. For subsequent years, CBO's estimates of the President's revenue proposals exceeded the amounts in the budget.

The House (H.Con.Res. 95) and Senate (S.Con.Res. 23) budget resolutions included different amounts of revenue reductions. The House included an estimated \$698 billion revenue reduction over 11 years (FY2003-FY2013), closely matching the President's tax cut proposals. The Senate included reconciliation instructions for a tax cut of no more than \$350 billion. Additional components of the President's original tax proposals were incorporated in the resolution, but not in the reconciliation instructions. The conference on the budget resolution produced separate tax cut reconciliation instructions for the House Ways and Means Committee and the Senate Finance Committee. Reconciliation instructions required the Ways and Means Committee to reduce receipts by \$550 billion (\$535 billion in tax cuts and \$15 in increased outlays) over the 11-year period. The Finance Committee was instructed to reduce taxes by no more than \$350 billion.

Soon after the House adopted the conference report (H.Rept. 108-71) on the budget resolution (April 11), the Senate indicated that no eventual tax cut legislation exceeding \$350 billion would be presented to the Senate. Many House members, expecting the larger tax cut amount (\$550 billion) to eventually emerge from a conference committee on the tax cut legislation, were unhappy with the Senate's internal agreement.

The Committee on Ways and Means reported (H.Rept. 108-94) out the reconciliation bill, H.R. 2 (the Jobs and Growth Reconciliation Tax Act of 2003), costing \$550 billion, including some increased outlays, on May 8. The House passed it on May 9. The Committee on Finance reported S. 2 (with no written report), its version of the reconciliation bill, on May 9. It contained revenue reductions of \$350 billion and some increases in outlays. Procedural issues required the Committee on Finance to report, gain with no written report, a new bill (S. 1054) containing essentially the same contents as S. 2. The Committee reported the bill on May 13. The Senate, after substituting the text of S. 1054 for the text of H.R. 2, passed the \$350 billion reconciliation bill on May 15.

¹⁹ This estimate does not include the larger interest payments resulting from the larger deficits or smaller surpluses occurring over this period that increases public debt.

On May 22, after extensive Republican leadership discussions over the reconciliation bill, a compromise was reached on an estimated \$350 billion multi-year tax cut. The conference committee on the legislation endorsed the agreement and reported (H.Rept. 108-126) the modified H.R. 2 on May 22. The House passed the bill in the very early hours of May 23. The Senate passed the bill before noon on May 23. The President signed it into law (P.L. 108-27, the Jobs and Growth Tax Relief Reconciliation Act or JGTRRA) on May 28.²⁰

OMB's July 2003 budget report estimated that the JGTRRA would reduce FY2004 receipts by \$138 billion (from baseline estimates). Over the period FY2004 through FY2008, OMB estimated that the law would actually increase receipts (compared to the Administration's original proposals, since the original proposal included a larger tax cut) by \$48 billion.

The law included the expiration of the tax changes by the end of 2005, with a reversion to previous law. CBO's August 2003 budget report estimated that JGTRRA would lower receipts in FY2004 by \$135 billion from CBO's baseline estimate (the law would also increase outlays by \$12 billion). Over the FY2004 through FY2008 period, CBO estimated that JGTRRA would reduce receipts (compared to CBO's baseline, which did not include the Administration's original tax cut proposal) by \$264 billion.²¹

Deficits and Surpluses

Surpluses and deficits are the residuals left after Congress and the President set policies for spending and receipts. Surpluses reduce federal debt held by the public which leads to lower net interest payments; deficits increase government debt held by the public, increasing net interest payments (assuming no change in interest rates). Reducing the deficit and eventually reaching a balanced budget or generating and keeping a surplus (the government had its first surplus in 30 years in FY1998) was a major focus of the budget debates in the late 1980s and throughout the 1990s. The President's FY2004 budget proposals included a deficit of \$307 billion in FY2004. CBO's March 2003 estimates of the President's proposals had a deficit of \$338 billion in FY2004.

CBO's January 2003 baseline estimates had the budget returning to surplus in FY2007, which then grew through FY2013. CBO's March 2003 revisions increased the near-term deficits and slowed, by one year, the movement to surplus. The growth

²⁰ Most of the major provisions of the legislation are scheduled to expire after calendar year 2004 or, after calendar year 2008. These expirations kept the total budgetary change from exceeding the \$350 billion limit set by the agreement. Extending the provisions through 2013 would raise the estimated cost of the legislation, compared to the baseline estimates, close to \$1 trillion over the 11 years.

²¹ Because most of the provisions were designed to expire either after FY2005 or FY2010, CBO estimated that the 10-year cost of the tax cut would be only slightly larger, \$271 billion, than the five-year cost, \$264 billion.

in the surplus, especially after FY2010, has been boosted substantially, in the baseline estimates, by the scheduled expiration of the 2001 tax cut at the end of 2010.

The House Budget Committee's adopted budget resolution had the budget move into surplus in FY2010; the Senate Budget Committee's resolution moved the budget into surplus in FY2013. Both the House- and Senate-passed versions of the budget resolutions amended the two committee-passed original resolutions, showing the budget moving back into surplus in FY2012. The conference report on the budget resolution (H.Rept. 108-71) had a deficit of \$385 billion for FY2004, a \$151 billion deficit in FY2008, and a small \$10 billion surplus in FY2012.

Table 5. Surpluses/Deficits(-) for FY2004-FY2008 and FY2013
(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	-\$158 ^a	-\$199	-\$145	-\$73	-\$16	\$26	\$65	\$508
President's F04 Budget, 2/3/03		-304	-307	-208	-201	-178	-190	—
President's FY04 Current Services 2/3/03		-264	-158	-40	5	29	51	—
CBO Revised Baseline, 3/7/03		-246	-200	-123	-57	-9	27	459
CBO Est. of the President's Policies, 3/7/03		-287	-338	-270	-218	-173	-166	-102
House FY2004 Budget Resolution, 3/21/03		-288	-324	-230	-168	-111	-87	37
Senate FY2004 Budget Resolution, 3/26/03		-282	-287	-218	-169	-128	-114	159
Conference FY2004 Budg. Res. 4/11/03		-347	-385	-294	-217	-166	-151	37
OMB MSR 7/15/03		-455	-475	-304	-238	-213	-226	—
OMB MSR, Baseline, 7/15/03		-455	-458	-241	-110	-78	-62	—
CBO Update, Baseline, 8/26/03		-374 ^a	-480	-341	-225	-203	-197	211

a. Actual deficit for FY2002 and FY2003.

Note: The CBO baselines assume, as required by the baseline construction rules, that because it exists in current law, all of the significant tax cuts adopted in the last several years will expire by the end of (calendar) 2010, thereby producing the surpluses in FY2013.

The summer 2003 budget reports from OMB (MSR) and CBO (*Update*) raised the expected deficit estimates for FY2004 and subsequent years. The MSR's current services baseline deficit estimate was \$458 billion for FY2004, falling to \$62 billion in FY2008. The baseline had a cumulative deficit (FY2004-FY2008) of \$949 billion. The Administration proposed a deficit of \$475 billion in FY2004, falling to \$226 billion in FY2008. These proposed deficits summed to a cumulative deficit of \$1,456 billion (FY2004-FY2008), \$506 billion larger than the cumulative baseline deficit estimate. The Administration's MSR deficit estimates did not include "what the Administration has previously indicated are expected but undetermined additional costs arising from the ongoing operations in Iraq, extending beyond 2003."²² (The President asked for and got from Congress, in the fall of 2003, an \$87.5 billion supplemental appropriation mostly for the ongoing operations in Afghanistan and Iraq.) Implementing the President's proposals would raise each year's deficit above the baseline and leave very uncertain any return to surplus after FY2008.

²² OMB, *Mid-Session Review*, July 15, 2003, p.1.

CBO's summer estimates raised its baseline deficit to \$480 billion in FY2004, falling to \$197 billion in FY2008 (and becoming a surplus of \$211 billion in FY2013 after the expiration of various tax cuts at the end of 2010). The cumulative (FY2004-FY2008) baseline deficit was \$1,445 billion in the CBO report. (The FY2004-FY2013 period had a cumulative baseline deficit of \$1,397 billion.)

CBO's Alternative Policies Not Included in the Baseline

CBO's summer report (August 2003) also included estimates of the "budgetary effects of policy alternatives not included in CBO's baseline." The alternatives are policies that have a high probability of being enacted or seriously debated. They included extending expiring tax provisions, the reform of the alternative minimum tax (AMT), Medicare reform — including a prescription drug benefit, and increasing discretionary spending at the growth rate of nominal GDP or at the average rate of discretionary spending growth from FY1998 through FY2003. The alternatives are all fairly costly, running from \$112 billion for AMT reform for FY2004 through FY2008 to \$608 billion for increasing discretionary spending at its recent historical growth rate for the same years.

During the 10 years, FY2004-FY2013, these costs become much large, ranging from \$400 billion for both AMT and Medicare reform, to \$1,564 billion to extend the expiring provisions, to \$2,833 billion for increasing discretionary spending at the recent historical rate. Combining these effects (and excluding the cost of increasing discretionary spending at the rate of nominal GDP growth) with the baseline deficit estimate and projection raises the FY2004 deficit to \$510 billion, the FY2008 deficit to \$577 billion, and, instead of becoming a \$161 billion surplus in FY2012, the alternatives produce a deficit of \$765 billion in that year and a deficit of \$826 billion in FY2013. Under these alternative policies, the cumulative deficit for FY2004 through FY2008 rises from \$1,455 billion in the baseline to \$2,577 billion under the alternatives. For the 10 year period, FY2004 through FY2013, the cumulative deficit rises from \$1,397 billion in the baseline to \$6,193 billion with the alternatives included. Under these alternative policies, the budget moves further into deficit and shows no signs of moving towards balance.

The Longer Run

Over a longer period, one running decades into this century, the Administration indicated (in its budget) that it expects, under existing policies and assumptions, large and continually growing deficits beginning sometime in the next decade. The retirement of the baby boom generation, beginning in large numbers within 15 years, will rapidly drive up spending on Social Security, Medicare, and other programs for the elderly, doubling these collective programs' size as a percentage of GDP. Their growth under current policy will raise the deficit (or reduce the surplus, if there is one) and put a severe strain on both the budget and the economy. The tax cuts and spending increases of the last few years have not caused these pressures, but they have intensified them.

The Budget and the Economy

The budget and the economy affect each other unequally. Small economic changes have a more significant effect on the budget than the effect of large policy changes on the economy. The worse-than-expected recent economic conditions that lasted into 2003 played a substantial role, directly or indirectly, in the deterioration of the budget outlook over those years and affected the outlook for FY2004. The improving economic outlook beginning in the fall of 2003 will likely improve the FY2004 budget estimates from OMB and CBO in early 2004.

After FY2004, the budget projections assume that the economy has returned to its normal rate of growth. Under policies that are in fiscal balance, a return to normal economic growth should reduce or eliminate a deficit or produce a surplus. The budget balance, using the CBO's August 2003 alternative assumptions, does not improve over the next several years. This implies that the budget has a fiscal imbalance, that the current policies of the government are producing outlays that are too large or receipts that are too small to produce a balanced budget or one in surplus during periods of normal economic growth.

The positive budget outlook forecast in early 2001 was substantially based on the favorable future economic conditions that were then expected along with policies that would continue producing surpluses. The outlook continued the overall improvement in the budget situation since the early 1990s. Much of this improvement had come from strong and sustained economic growth (and the rest from policy changes to reduce the deficit). When those favorable economic conditions faltered, so did the string of positive forecasts of the budget outlook. What good economic conditions give, bad economic conditions can take away. The unexpectedly lengthy economic weakness into 2003, the start of a recession in March 2001, the lengthy fall in the stock market, the policy responses to the September 2001 terrorist attacks, along with negative changes in the technical components of the budget estimates, raised outlays, reduced receipts (beyond policy changes), and eliminated the previously expected surpluses.

The FY2004 presidential budget documents and CBO's January 2003 budget report included information of the expected economic outlook and the budget's sensitivity to changes in selected economic variables. Both reports included tables showing the budget's sensitivity to changes in selected economic variables (this year, it is found in chapter 2 of the *Analytical Perspectives* volume of the President's budget and in chapter 5 of CBO's report). The effects of the variables are generally symmetrical. A higher rate of real economic growth (than assumed in the budget proposal) has approximately the same effect on the budget as same-sized lower rate of economic growth has, but in the opposite direction. If a 1% lower rate of economic growth reduces the surplus (or increases the deficit) by \$30 billion in FY2004 (from the OMB table; Table 2-6, p. 32, *The Budget of the United States Government, Fiscal Year 2004, Analytical Perspectives*), a 1% higher than expected rate of economic growth would reduce the deficit (or increase the surplus) by approximately \$30 billion. Changes in other variables generally have a smaller effect on the budgetary balance than changes in real GDP. Sustained changes in the

underlying economic variables tend to produce larger changes in the budget numbers than the effect of a one or two year change.

For Additional Reading

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